SOME DEFECTS IN THE PRESENT PENNSYLVANIA STATUTE ON PUBLIC UTILITIES

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The municipalities of Pennsylvania will be fortunate if they do not pay a heavy toll as a result of the mistaken policy of the public service company law of 1913 in dealing with the question of competition between municipalities and public service corporations. The lack of control by American cities over these corporations has resulted in an insistent demand that the states give to their cities power to exercise such control both by regulating these corporations and by enlarging the municipalities' power to engage in such enterprises. Aside also from any question of regulation, the steadily growing field of municipal functions has caused the cities constantly to enlarge the scope of their activities in the furnishing of public service. It is hardly germane to the purpose of this article to discuss the question of state regulation versus municipal regulation, but even if it be conceded that regulation by state commission is the proper method, there can be no justification for the restriction imposed by the act on the rights of municipalities to engage in the business of rendering public service.

The act provides that, before any municipal corporation may engage in the rendering or furnishing to the public of any service of the kind or character already rendered or furnished by any public service company in the municipality, the said municipality shall obtain the consent of the commission, except in certain cases where municipalities are already engaged in rendering such services. The commission may not give such consent unless it finds that the exercise of the right by the municipality is necessary and proper for the service, accommodation, convenience or safety of the public. This finding is subject to review by the courts. Since municipal competition will probably result in destroying or at least impairing the value of existing properties it must be an extreme case in which the commission and the courts will feel justified in consenting to such competition.

The protection from competition thus accorded to the public service companies is an asset of great value and should not have been given to these companies without exacting something in return. To do this it is not necessary to give municipalities the right of unrestricted competition. It is proper to protect public service companies from wanton destruction of their property, but in cases where the commission might refuse its consent to the municipality, the municipality should have been given the right to purchase the property of the private corporation at a valuation to be determined by the commission, which valuation should exclude any added value by reason of the protection from competition afforded by the act. It was proposed to accomplish this result by amending the provision so that municipalities should not be required to obtain the commission's consent except in cases where public service corporations had stipulated that they held their franchises upon indeterminate permits. This amendment was rejected by the legislature, probably because it applied the principle of the indeterminate franchise. In my own opinion, the legislature should have gone much further in this respect and provided for an indeterminate franchise not only in the cases specified in the amendment, but for all future grants. I include in my definition of the indeterminate franchise, of course, the obligation on the part of the municipality to purchase the property of the corporation when the franchise shall be terminated. The action of the legislature was a step backward that will tend to increase the tax paid by the public to the public service corporations, instead of lightening this burden.

The sections of the act dealing with the valuation of the property of public service corporations and the regulation of their securities issues will probably produce the same effects in their operation. When the bill passed the house the section dealing with valuations contained no reference to the stocks and bonds of the corporation or the earning capacity of the property. The senate inserted provisions permitting the commission to take into consideration the amount in market value of the corporation's stocks and bonds and the probable earning capacity of the property under particular rates prescribed by statute or ordinance or other municipal contracts or fixed or proposed by the commission.

It is true that this language has the sanction of the supreme court of the United States as expressed in the leading case of Smythe *vs.*

Ames. It must be remembered, however, that this case was a rate case, and the court expressly held that a fair rate was one based on the fair value of the property used in rendering the service. If the opinion had been followed in its entirety by the framers of the Pennsylvania statute, the language quoted would not have been so objectionable, although the case has always been subject to criticism for the reason that there is no necessary relation between the fair value of the corporation's property and the amount in market value of its stocks and bonds. The market value of the corporation's securities depends frequently upon the fact that it enjoys an unregulated monopoly, and has fixed its rates, not with a view to a fair return on the fair value of its property, but with the idea of charging what the traffic would bear. If it shall be held in such cases that the commission is bound to value the corporation's property with reference to the amount in market value of its bonds and stocks, since such valuation will furnish the basis for fixing the rates of the corporation, there will be a wide departure from the principle of Smythe *vs.* Ames.

In dealing with the vexed question of regulating the securities issues of public service corporations, the Pennsylvania law has adopted a compromise between the scheme of those who favored strict regulation and those who believed there should be no regulation at all. It may be conceded that it would be wise for the state not to interfere in this matter, if an ideal method of regulating rates and service could be devised, which would relieve operating officials from the double allegiance they now owe—to investors clamoring for dividends and to the public insisting on good service. So long as it is not possible to do this, I believe in the strict regulation of public service securities issues. Everybody admits that most of the trouble today is due to the over-capitalization of these properties. It seems obvious, then, that regulation to be effective should strike at the root of the evil and prohibit the issuing of these securities except for proper purposes to be defined in the law and in proper amounts to be determined by the commission.

I do not think the section in the act relating to this subject will prevent the issuing of watered stock. As the law now stands, a corporation may apply to the commission for a certificate of valuation before it issues any securities, or it may issue the securities first and notify the commission afterwards. It is urged in support of the latter provision that it is based on the recommendation of the Railroad Se-

curities Commission to Congress for the regulation of the issues of stocks and securities by interstate railroads. It must be remembered that the federal government has not the power in the first instance to control the security issues of corporations having state charters, and that the plan recommended to Congress is based on the only feasible method of regulation which the federal government can enforce. It is doubtful whether this method will be effective in this state for the reason that it leaves the determination of the purpose and amount of such issues to the corporations themselves. Under the constitution of Pennsylvania, corporations may issue stock for property or services. Now, the value of the property and services is a question of opinion, and opinions frequently differ widely. If the discretion is left to the corporation to decide the amount of stock to be issued in return for property or services, it will be possible to issue fictitious securities as easily in the future as in the past, and the prohibition in the act against the capitalization of franchises, leases and contracts of merger, will not prevent such practices, although this provision in the law, if it is sustained by the courts, will destroy the most fruitful source of watered stock in the past. I do not see, either, how the act will prevent the capitalizing of deficits and other improper practices. The New York law of 1907 limited the purposes for which securities could be issued to those which were proper charges to capital account and this should have been done also in Pennsylvania. It is not much use to prohibit the capitalizing of franchises if the corporation is permitted to issue stock or bonds to replace losses occasioned by extravagance, fraud or inefficiency.

In one other respect the act does not deal adequately with the question of securities issues. The commission is given power to investigate issues made after the date when the act becomes effective, and to institute proceedings for striking down fraudulent issues of such securities. It seems to me this power is too limited. I do not understand why fraud should have been privileged any more before January 1, 1914, than after that date. Aside from any question as to whether the commission should have the power to move to strike down fraudulent issues, there can be no doubt of the propriety of giving them ample power to investigate all issues. The act of Congress of 1913, under which the railroads of the country are being valued, granted the fullest power to the Interstate Commerce Commission in this respect, and it is necessary that any body charged with

investigating the history of a particular corporation should have the fullest power to inquire into its financial transactions.

A subject closely allied with the one just discussed is the acquisition of interests in public service corporations by other corporations. The act provides that no public service company may acquire a controlling interest in another such company or in its securities without the consent of the commission. It is well known that corporations are frequently controlled by minority interests. Even if this were not the case, the provision can be so easily evaded by dividing the control between two or more companies that it is hardly worth while to insert it in the act. It will be noticed also that no limitation is expressed upon the right of corporations other than public service companies to acquire such interest. The holding company as a rule is organized simply for the purpose of owning securities and is not affected by this provision. No control can be exercised in this matter without subjecting holding companies to the jurisdiction of the commission in this respect, as has been done in New York.

This discussion has up to this point dealt with the matters usually considered of most importance in public utilities legislation—franchises, valuations and capitalizations. I do not mean to overlook rates, as the rate question is without doubt the most important question. Some criticism is made of the law because it failed to provide that rates should be based on a fair return on the fair value of the corporate property used in rendering the service, in accordance with the principle of Smythe *vs.* Ames. There can be no doubt that this is the correct principle, but to place a declaration to this effect in the act would not make it any more binding on the courts, which must, in the end, pass upon all rate questions. I believe that the act has left the matter of rates just where it ought to be, and therefore do not feel it necessary to discuss this matter in this article. There are, however, a number of respects in which the law is technically defective, and these defects may cause more dissatisfaction in the practical workings of the law than those heretofore pointed out. These defects are principally cases where the commission is not granted any power, or sufficient power, to deal with a subject, and there can consequently be no corrective force of public opinion which may be depended upon to some extent to check evils resulting from the more important defects of the law, because in these cases the commission will have a rather wide discretion.

Article II of the act dealing with the duties and liabilities of public service companies omits several important provisions that were in the bill when it passed the house. By the provisions of clause c of section 1 of this article, public service companies are required to construct such extensions of their facilities as may be required to give adequate service. This does not include cases where the grant of a franchise is necessary before the extension can be constructed—for example, a street railway. The question of street railway extensions is one of the most difficult with which our cities have to deal. Public opinion today will not sanction the grant of street railway franchises upon the liberal terms in vogue twenty years ago, but the companies demand practically such terms before they will accept franchises for extensions. The result is a deadlock between the municipality and the company. Some parts of the community are left without transportation facilities and in other parts such facilities as are provided are inadequate. This is a condition which the municipality should have power to remedy without being obliged to grant franchises upon impossible conditions. If the city is willing to grant a franchise for an extension, the Public Service Commission should have the power to say whether or not the extension is reasonably necessary and whether the terms of the franchise are reasonable. If the commission should determine this to be the case then the street railway company should be required to build and operate the extension. The commission has the power to require gas and water companies to extend their mains. There is no good reason why street railway companies should not now be subjected to the same requirement. In practically every case the street railways of every urban district are operated as a unit and no opportunity exists for operating extensions independently. The law should take cognizance of this fact and require companies controlling the street railways of their respective districts to build the necessary extensions to their systems.

Another provision of the bill when it was originally introduced dealt with a subject similar to the one which has just been discussed; that is, the duty of one public service company to permit another company to use its facilities. This clause was stricken out entirely by the senate. If two public service companies are furnishing service to adjoining neighborhoods, it is desirable in many instances, if not necessary to the public convenience, that there should be an interchange of service between the two companies. It is true that the

supreme court of Pennsylvania in the case of Philadelphia, Morton and Swarthmore Street Railway Company's petition, 203, Pa., page 354 (1902), held the provision in the street railway acts of 1889 and 1895, giving one street railway company the right to use 2,500 feet of the tracks of another street railway company, to be unconstitutional. This decision was based, however, upon the view of the court that the legislature had no power to impose a servitude on the private property of one corporation for the benefit of another. If the Public Service Commission had been given the power to determine whether the proposed use was beneficial to the public interest, and could be exercised without substantial injustice to existing rights, and also the power of fixing the compensation to be paid for such use, it is probable that such a power would now be sustained by the courts.

The act does not deal satisfactorily with the subject of changes in tariffs and schedules. It leaves the right to initiate changes in tariffs and schedules with the public service companies but provides that no rate, practice or classification which shall have been determined by the commission shall be changed by the company within three years after such determination without the commission's consent. There is no objection to allowing the companies the right to make rates and tariffs, if this right be accompanied with the power on the part of the commission to suspend such rates or tariffs, pending an investigation, in which the burden of proof shall be upon the company to justify the change, as is now the case under the interstate commerce act.

In this connection it should be noted that the procedure before the commission is in accordance with the ordinary rule of law that the burden of proof is upon the complainant, except in cases where the complaint alleges an infraction of an order of the commission, in which cases the burden of proof is upon the parties complained against to establish the fact that they have complied with the order. The commission should have been given a wide discretion in matters of procedure, so that it might in any case require the public service company to assume the burden of proof. In contests between private individuals or municipalities and public service companies, the companies have a great advantage since the facts are almost entirely within their possession. In such cases, if the commission thinks it advisable, for the purpose of doing justice to all the parties to require the parties complained against to assume the burden of proof,

it should not only have the right to do this, but should also have the right to compel the defendant to submit inventories or other data pertinent to the issue before the case is tried.

The commission has not been given the power to deal with matters held to be optional with the public service companies, such as the granting of transit privileges by railroads on through shipments of freight and the carrying of express matter by street railways. In at least one of the large cities of the state the street railway company carries some newspapers and refuses to carry others and the court has held that with respect to this right the street railway is not a common carrier and has refused to prevent discrimination in its exercise. The result of course is the silencing of all adverse criticism by the papers enjoying the privilege.

A discussion of the defects of the law is hardly complete without some reference to the form of the measure, which is objectionable in several respects. There are too many definitions and they are not sufficiently concise. It does not add anything to the act to say that the term "common carriers" means "all common carriers, whether corporations or persons, engaged for profit in the conveyance of passengers or property, or both, between points within this commonwealth by, through, over, above, or under land or water or both." This appears to be simply saying that the term "common carrier" means "common carrier." Nor have I ever been able to understand why it was necessary to use nineteen lines in the attempt to define "facilities," only to conclude with the words "any and all other means and instrumentalities in any manner owned, operated, leased, licensed, used, controlled, furnished, or supplied for, by, or in connection with, the business of any public service company."

Section 12 of article III is another example of the invitation to litigation contained in the prolixity of the author's language and the drawing in of irrelevant matters. The first clause of this section provides that every public service company shall be entitled to the full enjoyment and exercise of all and every of the rights, powers and privileges which it lawfully possesses or might possess at the time of the passage of this act except as herein otherwise expressly provided. The second clause of the section provides that the duties, etc., of public service companies shall be subject to certain constitutional provisions. The construction of the act is a question for the courts, so that it would not seem wise to say in the act itself what effect it

shall have, and as every act of the legislature is subject to the constitution there can be nothing gained by inserting an expression to this effect.

This concludes the discussion of what seem to me to be the most important defects in the measure. Some objection has been made to provisions which give the commission discretion in dealing with certain matters—for example, depreciation. This is hardly a fair criticism. It must be assumed that the commission will administer the act honestly.

It should be said in conclusion that the act was the result of a compromise, as all important legislation usually is, and that in its present form it is a great improvement over the measure originally introduced. It is to be hoped that it will be still further improved by the next legislature so as to bring it into harmony with the best modern thought on public utility regulation as expressed in the statutes of other states—notably New York, New Jersey and Wisconsin.